

GUIDELINES
FOR
SALES AND USE TAX SAVINGS ARRANGEMENTS
FOR
PUBLIC CONSTRUCTION AND IMPROVEMENT PROJECTS

The guidelines have been prepared by the Alabama Building Commission (ABC) to provide administrative documents and procedures that complement ABC standard documents and procedures. The Sales and Use Tax Division of the Alabama Department of Revenue has confirmed that these guidelines conform to state tax laws and the rules and regulations of the Alabama Department of Revenue in effect as of May 7, 1997. **It is the responsibility of the Awarding Authority (Owner) who intends to implement these guidelines to confirm that these guidelines conform to state tax laws and the rules and regulations of the Alabama Department of Revenue in effect at the time of implementing these guidelines. For more information contact Mike Emfinger, Revenue Department, Sales and Use Tax Division, (334) 242-1570 or go to the web site, (www.ador.state.al.us/salestax/index.html).**

Pursuant to Title 40 (Revenue and Taxation), Code of Alabama 1975, the gross proceeds of the sales of tangible personal property to the State of Alabama, counties and incorporated municipalities, county and city school boards, independent school boards, and all educational institutions and agencies of the state, counties, and municipalities are exempt from sales and use taxes. Such entities may exercise their tax exempt status and save the costs of sales and use taxes to be paid on tangible personal property incorporated into their building construction and improvement projects. "Tangible personal property" will be referred to in these guidelines as "materials" and include materials, supplies, equipment, and other items necessary for the performance of building construction or improvement work by a contractor and its subcontractors.

In order to preserve its tax exempt status in a building construction or improvement project, the Owner must purchase the materials, not the contractor. Implementation of such an arrangement requires added administration by the contractor, design professional, and the Owner, the cost of which may not be offset by the tax savings in all cases. If care is not taken in the preparation of the bid the contract documents, the Owner may assume responsibilities and liabilities that traditionally belong to the Contractor. Tax savings arrangements should be implemented with the award of the construction contract; attempts to effect tax savings after materials have been ordered and delivered in the contractor's name of paid for by the contractor will not be honored by the Alabama Department of Revenue.

I. CRITERIA OF EXEMPTION

To effect tax exempt purchases through a construction contract the following criteria must be met:

- A. The Owner must appoint the contractor as its agent to purchase the materials.
- B. The contractor must purchase the materials in the name of the Owner.
- C. The vendor who sells the materials must be paid directly by the Owner with funds belonging to the Owner.
- D. The labor to install or erect the materials must be provided by a party other than the vendor who sells the materials to the Owner.

II. GUIDELINES FOR PROJECTS NOT INVOLVING PSCA FUNDING**A. CONTRACT PROVISIONS**

If the Owner determines that it is in its best interest to implement a tax savings arrangement, adequate provisions must be included in the contract to insure that the procedural criteria are met and that certain traditional responsibilities and liabilities relative to materials remain with the contractor. Enclosed are a sample specification section with an Agency Agreement and forms that are recommended for inserting adequate provisions into construction contracts. The basic elements of these provisions are:

- 1. The bidders (contractors, subcontractors, and vendors) are given notice of the Owner's intent to implement a tax savings arrangement.
- 2. Sales and use taxes are to be included in the bid prices and, thus, the contract amount, but the contract amount will be reduced by the amount of taxes saved based upon actual purchases.
- 3. A form of Agency Agreement is provided which will establish the agency role of the contractor and further document the contractor's obligations under the arrangement.
- 4. The contractor retains the traditional responsibilities and liabilities for the materials purchased, except that the Owner will pay vendors directly for materials purchased by the contractor as agent for the Owner.
- 5. The Owner's payments for materials directly to vendors also constitute payments against the construction contract amount.
- 6. The contractor's costs for administering the arrangement are to be included in the bid price and the contract amount.
- 7. Procedures for the administration of the arrangement are established and standard forms are provided.

B. PROGRESS PAYMENTS, SPECIAL FORM

The Owner's payments for materials and the resulting accumulation of tax savings must be accounted for when calculating the contractor's monthly progress payments. Enclosed are copies of ABC Form C-10ST, APPLICATION AND CERTIFICATE FOR PAYMENT (For Contracts Utilizing Sale/Use Tax Savings Agreements), which is the pay request format recommended by the ABC. If a project is to be administered by the ABC, this form must be substituted for standard ABC Form C-10, APPLICATION AND CERTIFICATE FOR PAYMENT. Also enclosed is a copy of ABC Form C-10SM, INVENTORY OF STORED MATERIALS, which may be used in calculating the value of stored materials each month.

It should be noted that in calculating the contractor's monthly progress payments, retainage is based upon completed work and stored materials despite the fact that the Owner has paid for the materials directly. Retainage is not to be withheld from direct payments to vendors.

C. FINAL ACCOUNTING BY CHANGE ORDER

The end result of a sales and use tax savings arrangement is the reduction of the amount of the construction contract by the amount of taxes actually saved during the course of the project. This is to be accomplished by change order prior to issuance of final payment.

III. PROCEDURES FOR PSCA FUNDED PROJECTS

In a PSCA funded project, the construction contract is a three-party contract in which the PSCA and the Local Owner (a city or county board of education or an education institution) are co-owners contracting with a construction contractor. If the Local Owner desires to exercise its tax exempt status in a PSCA funded project, an Agency Agreement for the purchase of materials **in the name of the Local Owner** must be entered into between the Local Owner and the contractor. The Local Owner will make direct payments to vendors for materials purchased for the project. **The PSCA will not be a party to the Agency Agreement nor will the PSCA participate in direct payments to material vendors.**

PSCA payments to the contractor will be processed the same as if a tax savings arrangement did not exist. The contractor will use standard ABC Form C-10, APPLICATION AND CERTIFICATE FOR PAYMENT to request progress payments, not ABC Form C-10ST. The contractor's pay requests will include the cost of materials **and sales and use taxes**. The pay requests will be processed for approval through the design professional, to the Local Owner, to the ABC, and to the

PSCA. The PSCA will make monthly progress payments to the contractor **which will include paying the contractor the cost of materials and sales and use taxes.**

A. **SEQUENCE OF PAYMENTS**

In order that the Local Owner may make direct payments to vendors from its PSCA funding, the following sequence of events and payments occur:

1. The contractor will purchase materials for the project as the Owner's agent, using the Owner's Tax Exempt Purchase Orders.
2. Upon submitting a monthly pay request, the contractor also forwards approved material invoices and summaries covered by the monthly pay request to the Local Owner for payment.
3. The contractor receives its payment from the PSCA **(which includes Sales Tax, if included in the contract).**
4. From its payment received from the PSCA, the Contractor forwards payment for the materials covered by the monthly pay request **(excluding Sales Tax)** to the Local Owner.
5. The Local Owner pays the Vendors **(excluding Sales Tax)** for the materials used in the construction project.

At this point, the contractor is the only entity benefiting from the sales tax savings. The contractor has received payment, including sales tax, from the PSCA, yet the sales tax is excluded from the contractor's payment to the Local Owner which is used to pay the vendors. On order to return the Sales Tax Savings to the Local Owner, the contractor must issue Change Order credit(s) to be deducted from the contract price. These Change Orders may be handled in two ways:

1. In the event a Change Order is needed for any regular purpose, such as the addition of materials or labor, the Tax Credit may be listed as another item of the Change Order.
2. A Change Order may be issued solely for the purpose of providing a credit to the Local Owner for the total amount of tax savings.

B. **CONTRACT PROVISIONS and AGENCY AGREEMENT**

The sample specifications and agency agreement contained in these guidelines **are not suitable for projects funded by the PSCA**, because they do not address the contractor's obligation to pay the Local Owner or other aspects of the required sequence of payments. The Local Owner's legal advisor should modify the sample documents to incorporate the appropriate language consistent with the Local Owner's authority and needs.